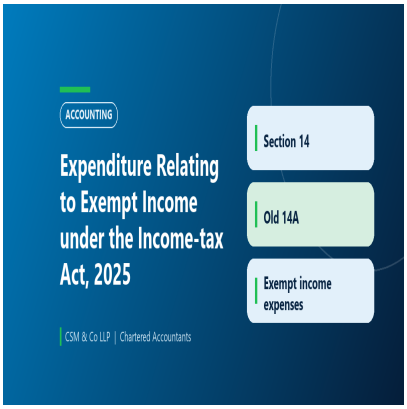

Expenditure Relating to Exempt Income under the Income-tax Act, 2025: Section 14 and Rule 14 (Old Section 14A and Rule 8D) (Tax Year 2026-27)

Description

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Quick summary

- Section 14 of the Income-tax Act, 2025 (old section 14A) disallows any expenditure incurred in relation to income that does not form part of the total income, even if the exempt income was not earned in that year (section 14(3)).
- If the Assessing Officer is not satisfied with the assessee's claim of expenditure, or with a claim that none was incurred, he determines the amount by the prescribed method, which is Rule 14: expenditure directly related to exempt income plus 1% of the annual average of the monthly averages of the opening and closing value of investments that yield exempt income, subject to a cap at the total expenditure claimed.
- The old Rule 8D had separate parts for interest and a 0.5% charge; Rule 14 of the Rules 2026 is shorter and uses 1% of the investment value.
- Dividend income is taxable and no deduction is allowed against it at all from 01/04/2026 (section 93(2)), so the disallowance in section 14 matters for genuinely exempt income such as agricultural income, exempt interest and exempt capital gains.

A taxpayer cannot claim a deduction for the cost of earning income that is not taxed. In the Income-tax Act, 2025 (from 01/04/2026) this is **section 14**, which replaces the old section 14A, and the method for working out the amount is in **Rule 14**, which replaces Rule 8D.

What section 14 says

1. **No deduction** is allowed for expenditure incurred by the assessee in relation to income that does not form part of the total income (section 14(1)). This applies irrespective of anything to the contrary in the Act.
2. **Determination by the Assessing Officer** (section 14(2)): if he is not satisfied with the correctness of the expenditure claimed in relation to the exempt income, or with the assessee's claim that **no** expenditure was incurred, he determines the amount by a **method that is prescribed**.
3. **Year of the expenditure** (section 14(3)): the section applies where the expenditure was incurred in a tax

year even though the exempt income has not accrued, arisen or been received in that year.

Rule 14: the prescribed method

The expenditure in relation to income that does not form part of total income is the sum of:

- **(a)** the expenditure **directly relating** to such income; and
- **(b)** an amount equal to **1%** of the annual average of the monthly averages of the opening and closing balances of the **value of investments**, income from which does not or will not form part of total income.

The total of (a) and (b) **cannot exceed the total expenditure claimed** by the assessee (Rule 14(2)).

Compared with the old Rule 8D

The old rule worked in three parts: direct expenditure, interest not directly attributable (by a formula on investments and total assets) and 0.5% of the average investment. Rule 14 of the Rules 2026 has only two parts, direct expenditure and 1% of the investment value, so there is no separate interest apportionment. Check the text of the Rule if a case turns on a particular head, such as interest.

Example. A company's investments that yield exempt income (for example, tax-exempt bonds) had an annual average of the monthly averages (of opening and closing balances) of ?1,00,00,000. The 1% charge is ?1,00,000. If direct expenditure on those investments (such as demat charges) is ?20,000, the disallowance is ?1,20,000, provided the company has claimed at least that much total expenditure. If it claimed only ?90,000 in total, the disallowance is capped at ?90,000.

What is "income that does not form part of total income"

This covers income excluded under section 11 and Schedules II to VII, agricultural income and other exempt receipts. **Dividend** is not exempt: it is taxed under section 92(2)(a), and Finance Act 2026 substituted section 93(2) to say that no deduction at all is allowed against dividend income or income from units of specified mutual funds and UTI units. So the earlier practice of claiming interest up to 20% of the dividend is gone, and the section 14 question for dividend does not arise.

Practical points

1. **Show the exempt-income expenditure in the accounts.** An assessee who shows that no expenditure was incurred must be able to support the claim, because the Assessing Officer can disbelieve it under section 14(2)(b).
2. **Separate funds.** Using separate bank accounts and clearly separate investments helps show that borrowed funds were not used for exempt investments.

How CSM & Co LLP can help

We compute the section 14 disallowance, plan investments and funding and defend the claim in assessment. Please reach out to our team and we will be happy to assist.

Frequently asked questions

Which section replaces 14A and Rule 8D?

Section 14 of the Income-tax Act, 2025 and Rule 14 of the Income-tax Rules, 2026.

What is the rule in section 14?

No deduction is allowed for expenditure incurred in relation to income that does not form part of the total income (section 14(1)). It applies even where the expenditure was incurred in a tax year in which the exempt income was not earned, accrued or received (section 14(3)).

How is the disallowed amount computed?

If the Assessing Officer is not satisfied with the correctness of the assessee's claim of expenditure, or with a claim that no expenditure was incurred in relation to exempt income, he determines the amount as prescribed (section 14(2)). Under Rule 14 it is the sum of (a) expenditure directly relating to exempt income and (b) 1% of the annual average of the monthly averages of the opening and closing balances of the value of investments, income from which does not or will not form part of total income. The total cannot exceed the expenditure claimed (Rule 14(2)).

Does the 1% apply to all investments?

Only to investments whose income does not or will not form part of the total income. Investments that give taxable income are left out of the average.

Is interest on borrowings to buy shares separately disallowed?

Rule 14 does not have a separate interest limb; the 1% of investment value covers the indirect expenses. Interest that relates directly to an investment giving exempt income is part of the direct expenditure in (a).

What about dividend income?

Dividend is taxable under section 92(2)(a), and from 01/04/2026 no deduction is allowed against it (section 93(2)). The section 14 disallowance therefore concerns income that is genuinely outside the total income, such as agricultural income and exempt interest or gains under the Schedules.

Official sources

- Income Tax Department: Income-tax Act, 2025 (sections 14, 92, 93)
- Income Tax Department: Income-tax Rules, 2026 (Rule 14)

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